

February 28, 2006

HONORABLE MAYOR AND CITY COUNCIL:

In compliance with City Charter Section 1204, and the City Council's adopted budget process, provided in this document are both the 2006-2007 City Manager's Budget Request and the 2007-2011 Five-Year Forecast and Revenue Projections for the General Fund and Capital Improvement Program.

The City Manager's Budget Request and Five-Year Forecast are key components of the City's annual budget process, and critical steps in the development of both the City's annual Operating and Capital Budgets and the Five-Year Capital Improvement Program (CIP). The City Manager's Budget Request includes the budget balancing principles that the Administration recommends be used to develop the 2006-2007 Proposed Budget. These principles are predicated on the most current projections for expenditure requirements and available revenue in the coming fiscal year. As the City's fiscal status for 2006-2007 is an integral part of the Administration's proposed approach to preparing next year's budget, a detailed discussion of the key economic, revenue, and expenditure assumptions for 2006-2007, and the subsequent four years, is provided as part of the 2007-2011 Five-Year Forecast and Revenue Projections sections of this document.

The Administration recommends City Council review, approval, and/or amendment of the proposed City Manager's Budget Request be provided as part of the Mayor's March Budget Message review process.

2006-2007 City Manager's Budget Request

This document provides both financial projections as well as a set of budget principles recommended by the City Administration for use in preparing the 2006-2007 budgets for the General Fund and selected Capital Funds. The recommendations contained in this City Manager's Budget Request have been formulated in the context of projections for a fiscal environment in which modest growth rates for City General Fund revenues, returning to a more historically moderate level of revenue growth, can be expected for the entire forecast period. This forecast projects that the economic environment in the region will neither return to the extremely high growth levels experienced in the late 1990s, nor drop back into the recession conditions which so devastated City finances in the first four years of the new decade. Although we have provided two alternate forecast scenarios that model the potential outcomes for more optimistic and more pessimistic conditions, the Administration recommends that the Base Case multi-year scenario be used as a backdrop for the City Council's immediate fiscal decision making.

2006-2007 City Manager's Budget Request (Cont'd.)

The forecast is built on the assumption that although the Valley economy and the associated City revenue performance will resume modest growth, expenditure levels of existing General Fund programs will exceed growth rates of General Fund revenue sources in all five years of the forecast period. The result is projections for reasonably small, but persistent General Fund shortfalls in each of the five years of the forecast, and the need for expenditure cuts, and/or revenue increases annually, until such time as a structural balance can be achieved.

This forecast updates a preliminary estimate for the 2006-2007 fiscal year, issued in November, that projected a \$76.1 million shortfall next year. As discussed later in this Transmittal Memorandum and in greater detail in this document, these updated projections indicate a significantly smaller General Fund shortfall for 2006-2007 in the amount of \$35.9 million. Although the size of the anticipated shortfall has fallen significantly from that projected in November, the problem is still formidable. Closing this gap will still involve some very tough choices and careful planning to minimize the need to make significant budget reductions in basic City services, all of which have suffered significant erosion in recent years. With four consecutive years of budget reductions already sustained, fewer and fewer choices remain that do not involve cutting core City service levels.

Projections for the selected Capital Improvement Program (CIP) revenues included in this Forecast remain relatively unchanged from that included in the prior Capital Improvement Program. For the major development-related capital budget revenues (which primarily support the Traffic Capital Budget), only a very small overall increase to the revenue estimates included in the prior CIP is forecasted, based on development activity projections provided by the Planning, Building and Code Enforcement Department and actual collection patterns. The overall presumption is that development activity will remain relatively flat over the forecast period, and down significantly from levels experienced in the first several years of the new decade. For the Construction and Conveyance (C & C) Tax, which supports a number of capital programs, it is anticipated that collections will fall from the record setting levels experienced in recent years but will normalize at levels above those assumed in the development of the last CIP. The phenomenal strength of the local real estate market has driven the growth in this category over the past several years. This sector, however, is now showing signs of a long anticipated downturn, which will impact City revenue collections. C & C Tax receipts are expected to stabilize at a lower and more sustainable level over the forecast period.

In approaching the 2006-2007 budget development process, the Administration proposes to utilize the overall set of budget principles outlined below. First and foremost, City Council priorities identified in prior policy sessions should guide our balancing strategy efforts. Protecting, to the extent possible, priority service areas such as public safety, meeting neighborhood needs (e.g., the Strong Neighborhoods Initiative), and delivering on capital project commitments will continue to be the overarching goals that set the context for the development of the Proposed Capital and Operating Budgets currently scheduled to be submitted on April 24, 2006 and May 1, 2006, respectively.

2006-2007 City Manager's Budget Request (Cont'd.)

Additionally, to the extent possible given the current fiscal condition, the Administration intends to protect and preserve our previously adopted corporate priorities related to performance-driven government, support for effective Council policy-making, neighborhood-focused service delivery, customer service, effective use of technology, and becoming the best public-sector employer.

In addition to the efforts to adhere to these overall goals and priorities, the Administration requests City Council consideration and confirmation, or revision, of a number of more specific principles to be used in formulating the budget. These proposed principles are summarized below in three overall categories: Balanced Budget, Satisfied Customers, and Engaged Employees.

Balanced Budget

- Balance the City's ability and capacity to continue providing essential services to the community, revive the economy, build strong neighborhoods, and stabilize the City's budget;
- Mitigate to the extent possible direct service reductions by utilizing a combination of ongoing expenditure reductions and increases or retention of ongoing revenue sources, coupled with one-time expenditure cuts, one-time revenues, and/or a portion of the reserves designated for budget balancing purposes, while continuing the City's high standards of fiscal integrity;
- In addition to strategies that achieve efficiencies and appropriate cost savings, utilize fee increases to assure that operating costs are fully covered by fee revenue. Continue to include fee structures that charge non-residents a premium for our services and discourage "abusers" of services. Provide careful consideration of the merits of retaining the major cost recovery fee for emergency communication services that allows continuation of current service levels of a major public safety service, and which faces a sunset or retention decision during this budget process;
- Leverage resources as much as possible and explore opportunities to establish new fees for services where appropriate;
- Continue with the elements of the current capital improvement plan that keeps money flowing to our economy. In addition, however, consider further deferrals of capital improvement program schedules for projects that create negative impacts on the General Fund;

2006-2007 City Manager's Budget Request (Cont'd.)

Satisfied Customers

- Defer consideration of any new program commitments and initiatives, unless those program commitments stimulate the local economy and job creation and/or are funded through redeployment of existing resources;
- Focus on protecting vital core City services for both the short- and long-term. Focus service reductions first in those areas that are least essential;
- Emphasize quality over quantity: do fewer things as required, but do them well;
- Consider alternative service delivery mechanisms (e.g., appropriate community partnerships, public-private partnerships, working with other jurisdictions to ensure no service overlap, outsourcing/insourcing services delivered by City staff, etc.) to reduce costs;
- Focus on improving employee productivity and continuously improving business practices, including streamlining, innovating, and simplifying City operations so that services can be delivered at a higher quality level, with better flexibility, and at a lower cost;

Engaged Employees

- Continue to make employee involvement a priority for budget balancing idea development;
- Ensure that an active budget communication plan with City employees is in place and utilized;
- Balance proposed reductions across the organization and employee groups, including a careful review of all non-essential overtime and non-personal/equipment expenses;
- Make every effort to eliminate vacant positions, rather than filled positions; and
- Continue to work together with employee bargaining groups to find ways to limit the number of employee layoffs.

In light of the current forecasted budgetary situation, in November, the Administration directed each of the six current City Service Areas (CSAs) (Community and Economic Development, Environmental and Utility Services, Neighborhood Services, Public Safety, Transportation and Aviation Services, and Strategic Support) to develop 2006-2007 budget proposals necessary to eliminate the projected General Fund shortfall utilizing these principles. For planning purposes, targets for the size of budget proposals to be submitted were set at 5% of General Fund Base Budget (adjusted) amounts for the Public Safety CSA and 18.2% for the remaining five CSAs.

The Mayor will issue a proposed March Budget Message in early March, which will then be discussed and/or amended, and adopted by the City Council. The contents of that Message will then provide specific guidance for the preparation of the City Manager's 2006-2007 Proposed Operating Budget and 2006-2007 Proposed Capital Budget/2007-2011 Capital Improvement Program. As required by City Charter, those Proposed Budgets will contain comprehensive

2006-2007 City Manager's Budget Request (Cont'd.)

plans for how the City organization will meet the City Council's priorities and community service needs while maintaining the fiscal integrity of the City. Additional input by the City Council and community will be incorporated into the budget through the Proposed Budget Study Sessions, Public Hearings, and the Mayor's June Budget Message Memorandum during the months of May and June 2006.

2007-2011 Five-Year Forecast and Revenue Projections

The 2007-2011 Five-Year Forecast and Revenue Projections portion of this document is divided into five sections.

1. **Elements of the General Fund Forecast** – This section begins with a description of the overall economic outlook and the expected performance of the economy over the five-year period, followed by detailed descriptions of the assumptions made concerning each of the General Fund revenue and expenditure categories. The Elements of the General Fund Forecast section ends with the information regarding the projected General Fund operating margin for each of the five years included in the forecast period.
2. **Base General Fund Forecast** – The forecast model itself is presented in this section. It includes a worksheet on the economic drivers (e.g., Gross Domestic Product, unemployment rates, etc.) that are expected to impact revenue collections over the next five years, and projections for each of the revenue and expenditure categories. The expenditure summary is divided into two sections:
 - *Base Case without Additions* – This section describes projections associated with existing expenditures only.
 - *Base Case with Committed Additions* – This section describes the existing expenditures (Base Case) along with those expenditures to which the City is committed and has less discretion, such as debt service payments and maintenance and operating costs.

The Five-Year Forecast discussion is based on the Base Case with Committed Additions scenario, which is considered the most likely scenario for the upcoming year.

3. **Additions and Deletions to the Base** – This section describes the committed additions considered in the forecast.
4. **Alternative Forecast Scenarios** – Because all forecasts are burdened with a large degree of uncertainty, two plausible alternative forecast scenarios are presented – an “optimistic” case and a “pessimistic” case. These cases are compared with the Base Case, with committed additions, to show the range of growth rates for revenues and the associated operating margins.

2007-2011 Five-Year Forecast and Revenue Projections (Cont'd.)

5. **Capital Revenue Forecast** – This section describes the estimates for construction and real estate related revenues that are major sources of funding for the City's Five-Year Capital Improvement Program.

Two appendices are also included in this document. The first appendix, prepared by the Planning, Building and Code Enforcement Department, documents the basis for that department's five-year projections for construction activity. The second appendix is a compilation of descriptions of the City's major General Fund revenue categories.

General Fund Forecast

Sections One through Four of this report describe the 2007-2011 General Fund Forecast that will be utilized to prepare the 2006-2007 Proposed Operating Budget. The updated projections for 2006-2007 included in this document show a \$35.9 million General Fund (Base Case with Committed Additions) gap between revenue and expenditures, with continuing incremental shortfalls in each of the subsequent years. As discussed previously, the persistent funding gaps reflect the assumption that expenditure growth will continue to outpace increases in revenues.

The size of the 2006-2007 shortfall, although up slightly from the shortfall projected for 2006-2007 one year ago, is down significantly from the shortfall presented in a preliminary forecast issued this past November. The major increase from February 2005 to November 2005 was due primarily to the use of one-time measures to solve a large portion of the 2005-2006 Budget deficit. From November 2005 to February 2006, the projected shortfall has fallen significantly due, in large part, to lower than anticipated retirement costs and additional fund balance available. The Police/Fire Retirement program City contribution costs are now estimated at levels far below those projected last year by the Retirement Board's actuary.

The full forecast, as always, is built upon a set of assumptions about the future economic environment over a five-year period. These assumptions have been formulated through the review of a number of forecasts of economic conditions, especially those of the UCLA Anderson School Forecast utilized by the City's consulting economist, and Stephen Levy, Chief Economist and Director of the Center for Continuing Study of the California Economy.

The overall presumption utilized in the Base Case forecast is that the City has experienced a resumption of very modest growth in our economically-driven revenues this year that will continue into the first year of the forecast; and that this pattern of very moderate growth, more closely tracking historic growth levels, will continue for the remainder of the forecast period. We continue to believe that the most crucial requirement for resumption of a more vigorous level of growth in the local economy is a significant turnaround in the employment situation. The local economy, however, continues to lag behind the nation, the State as a whole, and even the rest of Northern California in this crucial area of jobs creation. Last year the nation created more than two million jobs and the State created a solid 190,000 jobs. The local area, however, created less than 3,000 jobs. Although any growth is an encouraging sign, given the 220,000 jobs lost between 2001 and 2005, there is no sign that the region is poised to begin gaining back significant numbers of the jobs lost during that period. This forecast assumes, therefore, that the

General Fund Forecast (Cont'd.)

local area will see a slight growth of jobs in the near future, and that sustainability of this level of growth is a necessary prerequisite for the continuation of the modest City revenue growth projected in this forecast.

The general consensus continues to be that the super hot housing market (some believe it constituted a classic housing price bubble) will deflate instead of pop, with a plateau or only modest drop in home prices, a moderate decrease in sales and new buildings, and weak growth for the next several years. If this scenario occurs, the overall impact to the local economy should be modest. Construction and financial activities will likely take a big hit, but this impact can potentially be balanced out by job growth in other parts of the economy. The Base Case General Fund Forecast utilizes this premise. If, on the other hand, the slowdown in housing becomes more rapid and severe, the impact on the local economy could be much more serious. A rapidly declining demand for homes, and especially a large drop in home prices, would likely heavily impact consumer spending with the high potential to lead the Valley back into a slowdown or even a recession.

In terms of the impact of this Base Case projection for local economic conditions on City revenue sources, the picture is generally consistent with prior forecasts and, depending on your level of expectations, generally positive. Those hoping for an imminent return to the roaring economic growth levels of the late 1990s will be disappointed by this forecast. For those with more modest expectations, however, this forecast is a welcome contrast to the painful performance of the recent recession years.

As stated above, this General Fund Base Case Forecast update projects a 2006-2007 shortfall of \$35.9 million. This is followed by projections for net incremental shortfalls in each of the subsequent four years of \$39.0 million, \$11.4 million, \$15.2 million, and \$4.9 million, respectively. The continued presence of shortfalls in all five years of the forecast period, continues to indicate an ongoing structural problem: expected growth in revenues is not keeping pace with the growth in expenditures.

It is very important to reiterate that this forecast always utilizes an incremental approach to each year's projection. Under this approach it is assumed that the budget is completely balanced on an ongoing basis in each year. To the extent that a shortfall in any one year is closed using one-time measures, the shortfall in the following year would be increased by that amount (which is the case for 2005-2006 as \$31.22 million of that year's shortfall was solved with one-time solutions and therefore that amount was carried forward to 2006-2007).

Some caution is in order, however, when considering the significance of out-year projections. Given the decreasing level of precision to be expected in the later years of a multi-year forecast, the significance of the projections in the out years is not so much in terms of their absolute amounts, but rather in the relative size of the decrease or increase from the prior year. This information should be utilized to provide a multi-year perspective to budgetary decision-making, rather than as a precise prediction of what will occur.

General Fund Forecast (Cont'd.)

The following table compares last year's forecast to this year's forecast, and to the preliminary forecast update provided to the Council in November 2005:

	(\$ in Millions)				
	<u>2006-2007</u>	<u>2007-2008</u>	<u>2008-2009</u>	<u>2009-2010</u>	<u>2010-2011</u>
February 2005					
Incremental Surplus/(Shortfall)	(\$32.13)	(\$30.26)	(\$14.25)	(\$11.35)	N/A
2005-2006 Adopted Budget Impact	(\$31.22)				
Incremental Surplus/(Shortfall)					
Revised Forecast	(\$63.35)	(\$30.26)	(\$14.25)	(\$11.35)	N/A
November 2005					
Incremental Surplus/Shortfall	(\$76.15)	N/A	N/A	N/A	N/A
February 2006					
Incremental Surplus/Shortfall	(\$35.89)	(\$39.02)	(\$11.44)	(\$15.24)	(\$4.93)

The projection for 2006-2007 is improved from the \$76.1 million shortfall projected in our November preliminary forecast (which dealt only with the 2006-2007 fiscal year), reflecting a whole series of updates to revenue and expenditure estimates. In 2006-2007, the first year of the forecast, the size of the shortfall is significantly impacted by three factors. First, as previously mentioned, the size of the projected shortfall has fallen significantly due to the retirement contribution rates for the retirement systems (primarily Police and Fire) that have been approved within the last few weeks by both Retirement Boards. In the November 2005 Forecast, a significant rate increase (\$25.9 million) was estimated to be necessary for 2006-2007 based on prior data included in the Police and Fire Retirement Board's actuarial studies. Due to efforts to stabilize the contribution rates while ensuring the health of the Retirement Plan, adjustments to rate assumptions have been implemented that were considerably smaller than previously anticipated, resulting in approximately \$24.7 million in savings over the November forecast.

The second significant factor that reduced the size of the 2006-2007 forecast shortfall is the availability of an additional \$15.0 million in fund balance that has resulted from stronger than anticipated revenue collections in 2005-2006.

2007-2011 Five-Year Forecast and Revenue Projections (Cont'd.)

General Fund Forecast (Cont'd.)

Third, it should be noted that because these forecasts cannot presume City Council actions not taken, the forecast for 2006-2007 assumes that the sunseting of the Emergency Communications System Support fee scheduled for December 2006 will occur and that the Council will not renew the fee beyond that point. As a result, only a half year of proceeds from this \$19.8 million annual fee has been included in the 2006-2007 revenue forecast. Similarly, the four out years of the forecast presume no revenue from this source. If however, as the Administration will recommend, the Council chooses to renew the fee, the 2006-2007 shortfall would be reduced to approximately \$26.0 million.

Committed Additions

Reflecting previous City Council decisions, a number of specific “Committed” additions are included in this Base Case forecast in the years that they are projected to be required. The Committed Additions category primarily reflects projected maintenance and operating costs for new projects now in the Adopted Capital Improvement Program such as for street improvements, Communications Hill Fire Station, and bond-financed facilities for libraries, parks, and public safety that will be necessary to fund in the year those facilities come on line.

As noted below, two new items have been added to the costs of the Base Case Forecast, when compared to the forecast released in February 2005. Included in the Committed Additions are the following changes:

Funding to bridge the gap in the Community Facilities Revenue Fund to support the Hayes Mansion Conference Center in the amount of \$3.9 million per year has been added to reflect recent forecasts that there will be insufficient revenues in the fund to cover operating costs and required debt service payments for all five years of this forecast period.

New also to the Committed Additions category is the cost to pay for operating costs of New Park and Recreation facilities and bond financed facilities for libraries, parks and public safety. Previously only the costs to maintain the physical facilities were considered as “committed”. This has been changed to recognize that operating costs are an inevitable factor in budgeting for each of the affected years and should therefore be considered in the base forecast.

Comparison of Base, Optimistic and Pessimistic Cases

As has been the practice in these forecasts, in order to model the range of financial scenarios possible under varying economic conditions, two alternative revenue forecasts have been developed. “Optimistic” and “Pessimistic” revenue cases were created to model economic scenarios considered possible, but less likely to occur than the “Base Case”. In these scenarios revenue collections can be seen to diverge from the Base Case over the five years. These

2007-2011 Five-Year Forecast and Revenue Projections (Cont'd.)

General Fund Forecast (Cont'd.)

alternatives are presented to provide a framework that gives perspective to the Base Case. The Base Case Forecast is still considered, however, the most likely scenario for planning purposes. In developing these alternate cases, selected economic variables that are the primary drivers of the revenue estimates in the forecast model have been raised or lowered so that revenues are modeled at plausibly more optimistic or pessimistic levels.

The Optimistic Case differs from the Base Case in that it is one in which general economic conditions, particularly those that have a significant local impact, are more favorable than those assumed by the Base Case. In the Optimistic Case, interest rates stay lower as a result of a softer approach to raising interest rates than the Federal Reserve currently seems intent on pursuing. The lower rates provide strength to the housing market, which keeps consumer confidence high and, therefore, general economic growth (as measured by the Gross Domestic Product) is higher than the Base Case. Local employment is also much stronger than in the Base Case. Later in forecast period, increases in employment are being driven by the natural innovative cycle characteristic of the Valley's businesses.

In the Pessimistic Case, we model a scenario where the high price of oil increases even more and this combined with the falling dollar and rising national debt cause a significant increase in interest rates which in turn causes both home prices and resale activity to decline sharply. The decline in home values results in consumers feeling less wealthy and consumer confidence drops. The decline in consumer confidence combined with a desire to pay down historically high debt levels will result in a drastic slowing of consumer spending. This scenario also includes the view that a large number of Bay Area jobs are at risk of going offshore and will actually leave, leading to lower local employment that chokes off economic activity and drags down the economy. In this case, local revenues fall to levels much lower than the Base Case, staying lower for the entire forecast horizon.

Capital Revenue Forecast

Section Five of this report describes the 2007-2011 Capital Budget Revenue Forecast that will be used to formulate several major elements of the Capital Improvement Program (CIP). As in past years, the construction-related revenue estimates included in this report are derived from construction activity projections provided by the Planning, Building and Code Enforcement Department. The projections and their basis are described in a report prepared by that department, which is included as Appendix A of this document (Development Activity Highlights and Five-Year Forecast [2006-2011]). This activity forecast includes a review of specific projects that are in progress, as well as a general prediction of expected levels of new construction.

2007-2011 Five-Year Forecast and Revenue Projections (Cont'd.)

Capital Revenue Forecast (Cont'd.)

The following table compares the estimates for the economically sensitive capital revenue categories included in this Five-Year Forecast with those included in the 2006-2010 Adopted CIP.

Forecast Comparison Summary
(\$ in Thousands)

	2006-2010 CIP	2007-2011 Forecast	Difference	Change
Construction and Conveyance (C & C) Tax	94,000	119,000	25,000	27%
Building and Structure Construction Tax	44,765	49,952	5,187	12%
Construction Excise Tax	69,032	69,428	396	1%
Residential Construction Tax	985	1,214	229	23%
Sanitary Sewer Connection Fee	5,571	5,654	83	1%
Storm Drainage Connection Fee	2,586	2,624	38	1%
TOTAL	216,939	247,872	30,933	14%

Real estate activity (primarily housing resales) determines the collection level of one of the major capital revenue sources, the Construction and Conveyance (C & C) Tax. C & C Tax receipts have been extremely strong for the past two years, but are expected to stabilize to a more sustainable level over the forecast period. Because C & C Tax collections are expected to normalize at a higher level than previously estimated, the C & C Tax revenue estimates included in this forecast, totaling \$119 million, reflect growth of 27% from the prior CIP. This estimate is built on the assumption that collections in the current year will total \$44 million, will drop to \$27 million in 2006-2007, and will level off at \$23 million annually for each of the remaining years of the five-year forecast. Based on the phenomenal level of real estate activity in recent years, C & C Tax receipts reached a record setting high of \$46.7 million in 2004-2005. When the 2006-2010 Adopted CIP was developed, it was assumed that this extremely high level of real estate activity would not be sustained and that collections would begin to fall.

Through the first part of 2005-2006, collections still experienced significant growth over the prior year. However, in recent months, the rate of grow has started to slow and data for the month of February 2006 shows the first decline from the prior year since January 2003. While the softening of the real estate market is now starting to impact C & C Tax collections, receipts are expected to normalize at a slightly higher annual collection level than previously forecasted. The annual collection levels presumed in this forecast reflect what is believed to be a more sustainable level of housing resale activity and is based on the assumption that adjustments will continue to occur in the housing market.

The remaining five economically sensitive capital revenue categories are directly linked to development activity. Over the forecast period, construction activity is expected to remain relatively flat with valuation hovering around \$1 billion in each of the next five years. These

2007-2011 Five-Year Forecast and Revenue Projections (Cont'd.)

Capital Revenue Forecast (Cont'd.)

assumptions are consistent with those presented in the 2006-2010 Forecast. Construction activity peaked in 2000-2001 at \$1.9 billion, followed by a sharp decline that reached a low point of \$751 million in 2003-2004. From that low point, a modest recovery occurred in 2004-2005 with growth of 15% in that year. A minimal amount of growth is expected in each year from 2005-2006 through 2007-2008, with activity leveling off in the out years of the forecast. Based on the construction activity estimates and a review of revenue collection patterns, an overall increase in the construction-related taxes and fees of \$5.9 million, or 4.8%, is expected when comparing the 2007-2011 Forecast to the 2006-2010 Adopted CIP estimates.

Conclusion

Although this 2006-2007 City Manager's Budget Request and the 2007-2011 Five-Year Forecast and Revenue Projections for the General Fund and Capital Improvement Program report are being released amid signs of a modest economic recovery in the local economy, it is a recovery to a low and slow revenue growth level. The Forecast illustrates that even in this improved situation a structural imbalance in our General Fund budget continues, in that revenue growth is not enough to cover the growth in the City's expenditures in any of the years of the forecast horizon.

Given this forecast the Administration continues to recommend a proactive approach to addressing the continuing budget challenges we face, by continuing the variety of cost containment strategies that Council has supported, and by proactive planning for a strategy to close the projected funding gaps with as little impact on core City services as possible.

In summary, therefore, this document presents our most current projections for the budgetary situation both next year and for the following four-year period, and we recommend that the 2006-2007 City budget be prepared with these assumptions in mind. Further, we have included in this document recommendations for a set of principles that we believe to be appropriate for use in preparing the City Manager's Proposed Budgets. We ask for City Council review and confirmation/revision of these guidelines as part of the Mayor's March Budget Message process.

Finally, despite the continuing fiscal challenges that we face, we remain confident that through continued strong leadership of the Mayor and City Council, and utilizing the proven financial management and strategic thinking that has served us so well in the past, we can work collaboratively, and successfully to formulate a plan to continue to provide our citizens with quality services.

Les White
City Manager